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Theoretical and Pragmatic Approaches of Undeclared Work in Romania

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Abstract

Undeclared work in Romania is a very widespread phenomenon. The published information about the employment relationship worries us, having regard to the damage recorded by undeclared work. For this reason, without claiming a comprehensive approach, through this article we try to give answer to questions such as: What is undeclared work and how it is manifested in Romania? What is the level of undeclared work in Romania? What are the main causes of undeclared work? What measures can be taken to prevent, detect and stop undeclared work? What is the experience of other countries to combat undeclared work?

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1. Introduction

The level of tax evasion in Romania is very high and deprives the public budget of large sums, the social security contributions contributing around 24% to total tax evasion, most often due to the phenomenon of undeclared work.

Whatever the mode of manifestation, policy towards undeclared work should be addressed both in terms of deterrence of this phenomenon, by discovering and sanctioning negative facts, but also through encouraging the transfer of undeclared work into declared work area, based on tax morale (Eurofound, 2013).

The analysis underground economy in Romania and therefore the analysis of undeclared work it was in attention of many Romanian and foreign specialists, the study of this phenomenon indicating the connection between advantages and disadvantages, rationality and morality, causes and effects, induction and deduction, general and special, detection and combat, formal and informal.

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For these reasons, through this article we present some aspects of undeclared work in Romania, trying to find items that can lead to reducing the size of this phenomenon.

Thus, through the four parts of the article we will present the theoretical framework of undeclared work, the size of undeclared work in Romania, the factors causing the existence of this phenomenon and the possibilities to control and stop it.

2. Some theoretical coordinates of undeclared work

Both in specialized literature, and in practice, to describe the phenomenon of undeclared work in whole or in part is using a number of terms such as black labor, black activities, moonlighting, illegal work, irregular work, illegal employment, unregistered employment, hidden unemployment, informal economy and shadow economy, making thus referring to a profitable activity carried outside the legal framework regulated.

Whatever the term is used, undeclared work is defined as: ‘any paid activities that are lawful as regards their nature but not declared to public authorities, taking into account differences in the regulatory system of Member States’ (COM, 2007), being excluded the criminal activities and work which should not be declared; ‘income from productive economic activities which are legal and taxable, but on which income tax, social security contributions, VAT, etc., are not paid, because they are not reported to the tax, social security or customs authorities’ (Feld and Larsen, 2012); ‘employment which, while not illegal in itself, has not been declared to one or more administrative authorities’ (OECD, 2004, p. 232); ‘an economic activity carried out by workers and economic units that is – in law or practice – not covered, or is insufficiently covered, by formal arrangements’ (ILO, 2010); ‘work that is not highlighted, taxed, protected, ensured or social assisted, the worker is to the discretion of the person in favor to which performs the work’ (Local Labor Inspectorate from Sibiu, Romania, 2014).

Due to its complexity, undeclared work should be regarded not only as a consequence of tax evasion. So, to combat it are required relevant analyzes in institutional, cultural, social and structural context (Pfau-Effinger, 2009).

In this context, public authorities and experts achieved analysis and research on: the forms of undeclared work; the methods of measuring undeclared work; causes that generates undeclared work; the harmfulness of undeclared work; the measures for preventing and combating undeclared work.

Undeclared work has multiple forms of manifestation, the three main types are: undeclared work performed totally or partially in enterprises; own-account undeclared work for individuals or legal persons; undeclared work by providing services directly to kin, neighbors, friends and acquaintances (ILO, 2013). Based on these types, in each country the economic, social and political conditions can determines a diversified manifestation of undeclared work. For example, based on inspections made by the authorities in Romania has been found that black labor is manifested by: work performed in enterprises without any labor standards, totally unregistered and without being subject to taxation, performed without the existence of an employment contract; activity carried out in enterprises partially recorded, by using the envelope wage system for undeclared work; the use of civil conventions in order to highlight the work for a period of 3 hours per day, in reality the work being performed between 8 and 12 hours per day; profiteering, illicit trade and smuggling; carrying out the activity in so-called probation period without being evidenced and subject to taxation; unregistered work performed in households; occasional or seasonal work (Local Labor Inspectorate from Sibiu, Romania, 2014).

Is it difficult to quantify undeclared work? What methods and procedures may be used to measure undeclared work? Many experts have provided pertinent answers to these questions, based on substantial analysis of undeclared work. Thus, were identified three methods of measuring undeclared work (Feld and Larsen, 2012), respectively: indirect methods (the income gap method; the transactions approach; the currency demand approach; the electricity consumption method; the hidden variable approach); direct methods (the direct surveys; the actual tax auditing and other compliance methods; the tax morale instead of tax evasion); experimental methods (analyze the theoretical predictions of tax compliance).

Using the methods of measuring undeclared work and observing its forms of manifestation allow identification of factors which generates the appearance of this phenomenon. The particularities of each country can be found both in the number and in the extent of those factors which causes undeclared work, in this way are identified economic, social, political and cultural factors (Pfau-Effinger, 2003). Geographical aspects put their mark on the forms of undeclared work. In disadvantaged and rural areas, undeclared work is often found as mutual aid for kin, neighbors

and friends (Williams, 2004), while the payment system, the type of contract and the sector of activity are the main elements that differentiate undeclared work performed by men and women (Williams and Windebank, 2006). In areas where the political system requires less intervention in the labor market, the level of informal economy is higher and the most often used payment system is the envelope wage (Vorley and Williams, 2012).

The negative impact of undeclared work on economic and social environment determines finding solutions to prevent and combat this phenomenon. Thus, the transformation of undeclared work into legitimate work requires: cost benefit analyzing of each measure taken and identifying the number of jobs that can be created (Renooy, 2007); identifying differences between informal employment and favors paid (Williams, 2006); clear establishment of the rights of employees and proper exercise of those rights (Daza, 2005); diversification of the inspection activities for the purposes of changing the behavior of employers and employees (Di Porto, 2011); identifying the areas where it is a high level of undeclared work (Williams and Round, 2010); establishment of appropriate measures for detection, prevention and combat the undeclared work, for each form of manifestation (ICENUW, 2010)

3. Level of undeclared work in Romania

Worker exposure to a high risk of poverty, the existence of inadequate working conditions, the lack of job security, undermining of the access to social security, substantial reduction of tax revenues are elements considered by László Andor, Commissioner for Employment, Social Affairs and Inclusion, which defined undeclared work as a scourge (European Commission, 2013).

In Romania, the data presented in the annual reports issued by the Labour Inspectorate and the Fiscal Council, as well as data obtained through surveys highlight a very high level of undeclared work.

If in 1996, there were approximately 293 000 employees in the informal economy, representing 4.4% of all employees in the economy, the situation has worsened greatly, so that, in the year 2012, 1.445 million people were in shadow economy, respectively 23% of all employees in the economy (Fiscal Council, 2013).

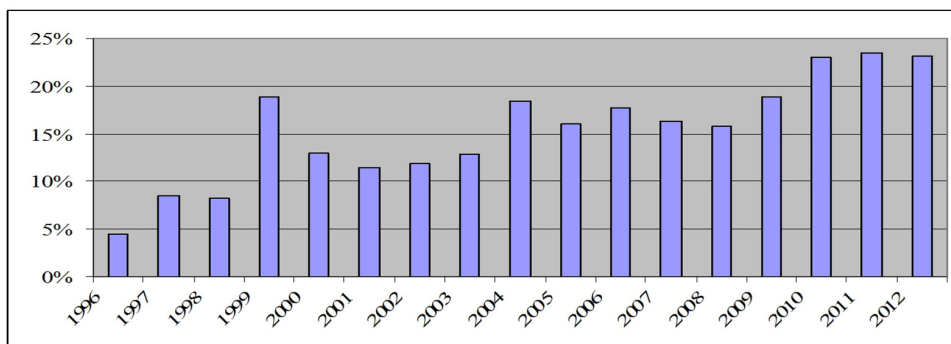


Figure 1: Evolution of the weight of employees in the informal economy in total employees in the economy

Source: (Romanian Fiscal Council, Annual Report 2012)

One aspect that should worry the authorities is related to the number of citizens who performed undeclared work and those who would accept to perform moonlighting. According to a survey conducted on a sample of 5230 people, from 5-12 May 2009, only 29.84% of the interviewees answered absolutely no to the question 'You work illegally?' A high percentage (60.48%) of those surveyed would have accepted moonlighting invoking the level of remuneration and about 506 people have given up carrying undeclared work due to the disadvantages of this phenomenon (Myjob, 2009).

From its establishment until now, through controls carried out by Labour Inspectorate from Romania in the field of labor relations was found a large number of employers who used undeclared work and a large number of people identified as working without legal forms. Thus, only from January to December 2012 were made 98498 controls being detected and sanctioned for undeclared work 5980 employers and 11326 persons without legal forms (Labour Inspectorate from Romania, 2012).

In Romania, during 2000 – 2012 the number of employers found to have used undeclared work and the persons identified to work illegally is as follows:

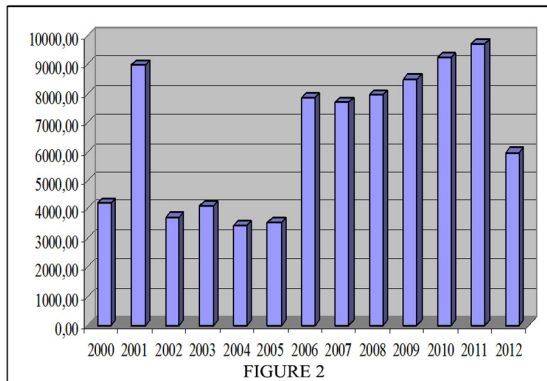


FIGURE 2

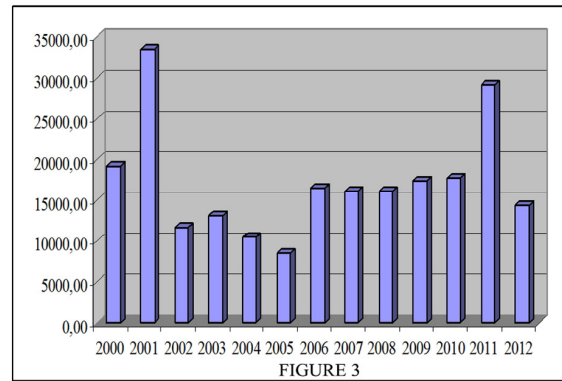


FIGURE 3

Figure 2: Trend in the number of employers found to have used undeclared work

Figure 3: Trend in the number of people identified as working without legal forms

Source: (Activity Report of Labour Inspectorate, <http://www.inspectiamuncii.ro>)

Using campaign controls, thematic controls and background checks, in the period January-September 2013 were identified in the field of undeclared work 4417 employers and 12264 people (Labour Inspectorate from Romania, 2013). The injury to public budget by undeclared work resulted in intensification of controls and the tightening of sanctions, so, according to press releases, from 6 January to 28 February 2014 were applied fines totaling 15427900 RON, with the detection of 2076 people without individual employment contracts (Labour Inspectorate from Romania, 2014).

Increasing the number of controls conducted, have determined the application of a large number of sanctions, their evolution during 2000 – 2012 is as follows:

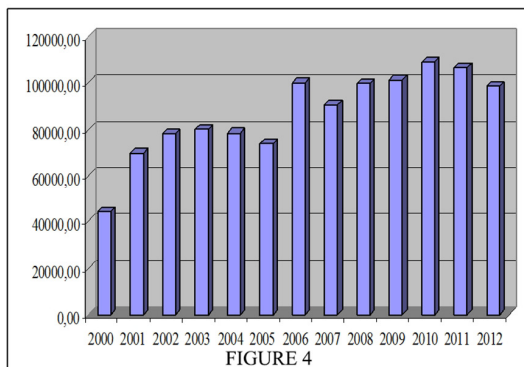


FIGURE 4

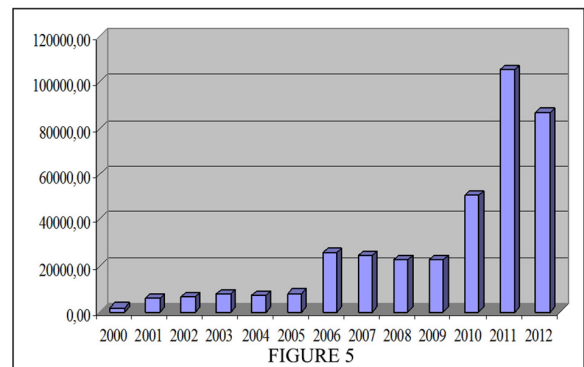


FIGURE 5

Figure 4: Trend in the number of controls carried out in field of labor relations

Figure 5: The evolution of fines for undeclared work (thousand RON)

Source: (Activity Report of Labour Inspectorate, <http://www.inspectiamuncii.ro>)

In terms of the size of the underground economy for 2013, second place occupied by Romania among the Member States do not honor us, its size in % of off. GDP was 28.4% (Schneider, 2013).

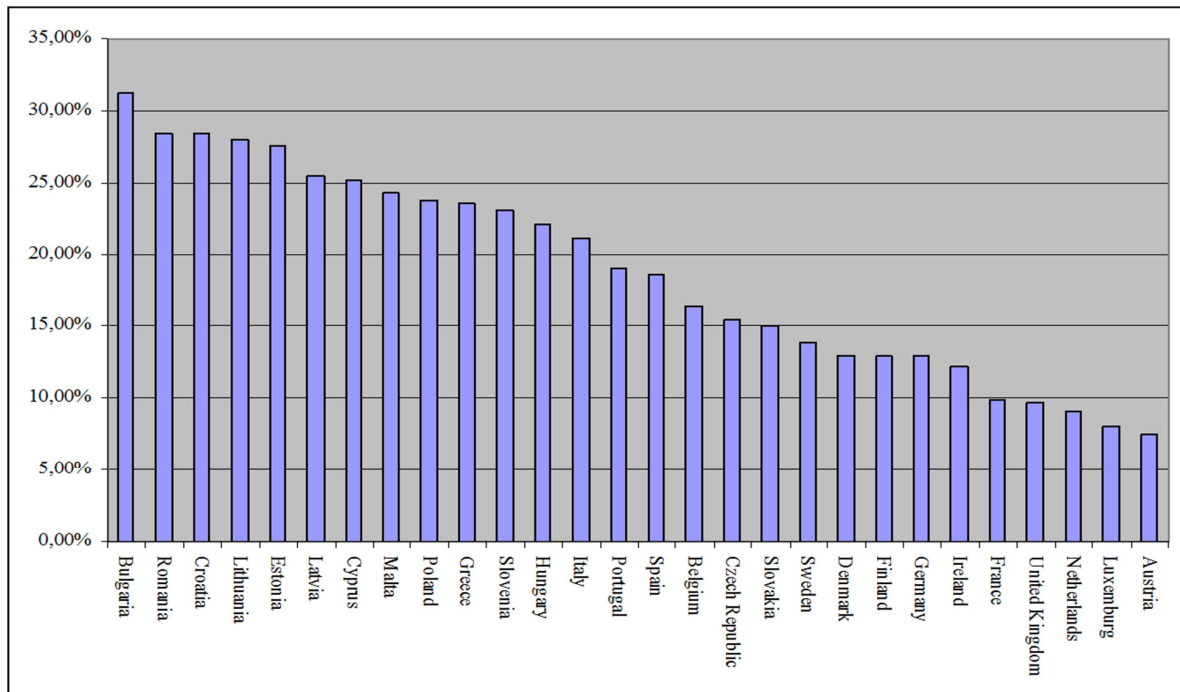


Figure 6: The size of the underground economy in the EU Member States in the year 2013
(In % of off. GDP)

Source: (Schneider, F., 2013)

This high percentage of the underground economy require the identification those causes that determine undeclared work in Romania, considering the legal aspects, the economic situation of employers and employees and their level of education.

4. The main causes of undeclared work in Romania

The negative effects of undeclared work, both the short and the long term can be found for each individual and for the entire society. The causes of undeclared work are varied, with a multi-factorial determination.

Based on the recorded values of certain indicators and international comparisons, we present the main factors that determine the high level of undeclared work in Romania.

Firstly, fiscal aspects are invoked as the main causes of undeclared work. Most of the operators of the labor market from Romania consider the labor taxation as high, thereby generating an inclination towards undeclared work. Is it true this assessment? From the perspective of personal income tax rate, applying a flat tax of 16% puts Romania in 2013 among the countries with relatively low tax, much below the average worldwide, respectively Europe average - 33.02% , EU average - 37.82%, OECD average - 41.51% and Global average - 31.44% (KPMG, 2014). But, the real costs of employment should not neglect the social contributions and benefits from them. From this perspective, the cumulative rates of social security contributions paid by employees and employers in Romania (about 55%) is the highest in the region and well above the level applied to developed countries, respectively Austria - 39.69%, Germany - 40.05%, Japan - 27.89%, Luxembourg - 23.36%, Switzerland - 12 50%, UK - 25.8% and USA - 19.3% (OECD, 2014). With all these high values in Romania the share of social contributions to GDP has recorded 9%, for the year 2012, while the average in the EU Member States was 14% (Eurostat, 2014a).

Secondly, the imbalance between total demand and total supply of jobs, as well as absence of proper correlation between the number of graduates of various forms of education and the labor market demand are factors that lead to an increase in Undeclared work in Romania. With an unemployment rate of 7.3% in January 2014, Romania was ranked below the EU average which was 10.8% (Eurostat, 2014b). This aspect should not enjoy us, because the most affected category of Romania was the young under 25 years old in urban area, with an unemployment rate of 32.5% in the second quarter of 2013.

Thirdly, earning was often mentioned in survey, as a reason why employees resort to carrying undeclared work. Romania is among the countries with the cheapest labor costs in Europe. At the end of the second semester of 2013, the monthly minimum wage of a Romanian employee was 157.5 Euro, the lowest among EU member states, at a great distance from Luxembourg, Belgium, the Netherlands, Ireland, France and the UK, where the minimum monthly wage was over 1200 Euro (Eurostat, 2014c). The same great gap was registered in the annual net earnings, which in Romania in 2012 were 3606.38 Euros, while in Sweden, Belgium, Luxembourg, Germany, Austria, Denmark, Finland, Netherlands, United Kingdom, France, Italy, Ireland, Spain, Greece, Malta and Slovenia values were over 10,000 Euro (Eurostat, 2014d).

Fourthly, although there are several active measures to increase employment, their inefficiency and the gap between their impacts may increase the level of undeclared work. The data presented by the National Agency for Employment from Romania, by the end of 2013 regarding the structure of unemployment by level of education (Romania National Agency for Employment, 2013) point out a very large number of people with no education and with primary, secondary and vocational education, that are looking for a job (69.49% of all people looking for a job), which, from our point of view involves a significant role of the training and retraining programs. In fact, the impact of training on employment from Romania is relatively low, recorded in January 2014 the value of 3.13% of total employment, at a long distance from the labor mediation - 88.02% and the information and professional advice - 17.61% (Romania National Agency for Employment, 2014).

Fifthly, we consider inappropriate behavior of taxpayers, in conjunction with their ability to circumvent the law as factors that generate multiple cases of tax evasion, and thus a high level of undeclared work. The elements that make greatly their mark on the behavior of the taxpayer against undeclared work and where public authorities have to act are the tax burden, a fair and impartial application of the law in this area, a responsible relationship between the taxpayer and public officials, adequate and timely information on the consequences of undeclared work. Although there was an improvement in the level of voluntary compliance (the degree of voluntary compliance of payment for the year 2012 was 79.8%, compared to 72.1% in 2006; the level of voluntary compliance in reporting for the year 2012 was 90.4%, compared to 84.5% in 2006) its level remains relatively low in payments, with repercussions on arrears and public expenditure (National Tax Administration Agency from Romania, 2012a).

The presentation of these factors that influence the level of undeclared work in Romania, and the presentation of the negative values of certain indicators requires extensive measures to be taken by public authorities, both to prevent and to stop this phenomenon. Also, should not be neglected aspects such as economic and financial instability for businesses, the vulnerability of large socio-professional categories, the desire to record a significant profit / earnings within a short period and disparities between penalties applied for employers and employees.

5. Modalities to combat undeclared work

Whether are used direct methods (for control and punishment) or indirect methods (to influence attitudes towards the employment relationship) the fight against undeclared work must exist.

In this respect, the measures taken must allow: reducing the financial attractiveness of undeclared work by using a rational tax system, both in terms of taxes and social contributions; simplification of administrative acts, with a beneficial effect on the cost of compliance; establishing of an appropriate mechanisms for the supervision and sanctioning of undeclared work, as well as strengthening of these mechanisms; strengthening the information exchange between EU Member States for detecting and combating undeclared work; raising awareness on the negative effect of undeclared work (Jensen J. and Wöhlbier F., 2012).

The particularities of undeclared work from EU Member States have generated a series of measures to prevent and combat this phenomenon, often with success. Thus, based on published information (Eurofound, 2014) can be taken into account:

| State | Measures against undeclared work |
|-----------------------|--|
| Austria | use of 'household services cheque' scheme to improve social protection for workers in the field, allowing home service users to make special payments instead of the cash, including social security contributions; specific regulations for the registration of workers in the construction sector; combating social fraud by the liability of the client; specific regulations regarding private geriatric nursing system; |
| Belgium | possibility of making by the unemployed of a neighborhood service for individuals, local authorities, non-profit associations or schools, up to 45 hours per month; creating an organization to improve coordination of the parties involved in the prevention of social fraud; using a system of vouchers for services to stimulate job creation; use of e-government in the social security; establishment of a service for social information and investigations; use of an information system regarding foreign labor; |
| Denmark | increase awareness of the negative effects of undeclared work and behavior change against undeclared work by Fair Play campaigns, by requiring employers to keep logbooks for employees, if any errors are found, or warnings regarding sectors and locations where checks will be carried out; introduction of an deductible expenses of 2,000 Euro for each family member aged over 18 years, which include the payment of cleaning services, gardening, child care, by the project Home-Job Plan; tax exemptions for work performed at home for young people under 16 and pensioners; |
| Finland | use of the reverse VAT in the construction sector, so that the payment of VAT to be the responsibility of the buyer; introduction of a tax return system for earnings in some sectors such as construction, hotels, restaurants, personal services; |
| Germany | exemption from the payment of social security contributions for the salaries lower than 400 euro; agreements between the social partners to combat undeclared work, the latest agreements are those concluded for painters in 2010 and for the textile industry in 2012; |
| Poland | creation of voluntary work teams, budgeted and supervised by the Ministry of Labour to provide educational activities to young people under 25 years in vocational training; development of some programs for high school graduates to find their first job; introducing specific measures on the legalization of childcare activities and other activities performed at home; |
| Romania | establishment in 1998 of The Builders' Social Fund, a privately run welfare organization of social protection of the construction sector from Romania, providing the conditions for a multi-dimensional approach to combat illegal employment; deployment of sectoral campaigns by the Labour Inspectorate, in partnership with the tax authorities; publication of the country report on the employment situation; inter-institutional approach to the problem of undeclared work, which includes stiffer penalties for employers; |
| United Kingdom | elaboration of studies and research regarding the workers motivation for undeclared work; the financial advice from non-profit organizations for micro-enterprises and self-employed people, in preventing and combating undeclared work; creating teams for combating undeclared work with representatives from the field of construction, taxi and courier services, catering and hotel services and guest houses; initiating a national public advertising campaign for the licenses that are required for labour providers in the agri-business industry; establishing a relationship between clothing industry and fashion industry; the opportunity for unemployed people to test a business idea for self-employment for a limited time period, without losing unemployment benefits. |

Table 1: Examples of measures taken by EU member states against undeclared work

Source: (Eurofound, 2014)

In Romania, aspects of prevention and combating undeclared work can be found in fiscal administration strategy over the medium term, with three priority axes of tax administration policy, namely: combating tax evasion; increasing the collection efficiency and reducing management costs; encouraging voluntary compliance (National Tax Administration Agency from Romania, 2012b).

6. Conclusions

Without claiming an exhaustive approach, theoretical and pragmatic aspects from this article provides answer to those five questions specified by us in abstract. Because many negative aspects were highlighted, we consider undeclared work as one of the serious problems of the Romanian economy, for which must be found relevant solutions. Experience of developed countries could help us, and the measures to prevent and to combat the undeclared work should not be written only in official documents, they should be reflected in concrete actions.

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